RECORD AND BRIEFS

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IN THE

Supreme Court of the United States

EXPRESSIONS HAIR DESIGN, ET AL.,

Petitioners,

v.

ERIC T. SCHNEIDERMAN, IN HIS OFFICIAL CAPACITY AS ATTORNEY GENERAL OF NEW YORK, ET AL.,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF AMICI CURIAE INTERNATIONAL CENTER FOR LAW & ECONOMICS AND SCHOLARS OF LAW AND ECONOMICS IN SUPPORT OF RESPONDENTS

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INTEREST OF AMICI CURIAE[1]

The International Center for Law & Economics is a nonprofit, non-partisan global research and policy center. It works with more than fifty affiliated scholars and research centers around the world to promote the use of evidence-based methodologies in developing sensible, economically grounded policy that will enable business and innovation to flourish.

The Center is joined as amici curiae by several law and economics scholars, who are professors at leading U.S. universities. Their titles and affiliates are listed in an Appendix.

SUMMARY OF ARGUMENT

Petitioners base their First Amendment argument on two premises: first, that surcharges are "more effective" than discounts at altering consumer behavior; and second, that surcharges and discounts are economically equivalent except for their labels. Under this view, because the only difference between discounts and surcharges is how they are framed, it must be this framing that leads to the difference in consumers' responses. To explain why Petitioners believe this is true—and, thus, to maintain their claim that New York's surcharge prohibition is an impermissible restriction on speech—Petitioners and their

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[1] The parties have consented to the filing of this brief. No counsel for a party authored this brief in whole or in part, and no person other than amici and their counsel has made any monetary contribution to the preparation or submission of this brief.

amici rely on the behavioral economic concepts of "framing" and "loss aversion." They claim that the State impermissibly wishes to prohibit surcharging because these cognitive biases render surcharge labels more effective than discount labels in altering consumers' preferred form of payment.

Petitioners' premises are wrong. There is no sound evidence that the asserted behavioral theories are at work here, or that credit-card surcharging—much less the mere label used to describe the practice—more greatly affects consumers' chosen method of payment than cash discounting. In fact, some of the studies on which Petitioners and their amici rely suggest the opposite. The Court should not rely, in the absence of sound supporting evidence, on a malleable theory that can be used to support contradictory positions.

Moreover, surcharges and discounts differ in material ways beyond the words used to describe them. Surcharging—but not discounting—enables merchants to engage in certain pricing and sales practices that explain both consumers' different responses to them, as well as the State's interest in regulating them differently.[2] And while Petitioners lack empirical support for the behavioral claims at the heart of their First Amendment argument, the evidence from

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[2] Whether it is advisable as a matter of economics and policy for the State to treat surcharges and discounts differently is not at issue here. What is at issue is the adequacy of the particular economic and empirical assertions that Petitioners adduce in support of their First Amendment claims.

countries that permit surcharging reveals that merchants often use surcharges to engage in these types of pricing practices.

This Court should thus reject Petitioners' invitation to base constitutional doctrine on a behavioral hypothesis unsupported by any sound empirical evidence—especially where, as here, that result could potentially expose consumers to the type of conduct that the State's law seeks to prevent.[3]

ARGUMENT

I. This Court Should Not Strike Down A State Law Based Upon Behavioral Economic Theories Unsupported By Sound Evidence.

Petitioners' First Amendment argument relies upon a claim, derived from behavioral economics, that credit-card surcharges are more effective than cash discounts at altering consumers' chosen payment method—and that this difference is solely a result of how each is labeled. The greater "effectiveness of the surcharge label," Petitioners say, is why they "seek to employ it." Pet. Br. 7; *see also* Pet. Br. 34 ("[P]etitioners wish to frame the cost of credit as a surcharge so that consumers make better decisions."). And they insist that New York's law must satisfy heightened

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[3] For a more thorough discussion of these issues, see generally Todd J. Zywicki et al., *Behavioral Law & Economics Goes to Court: The Fundamental Flaws in the Behavioral Law & Economics Arguments Against No-Surcharge Laws*, Int'l Ctr. for L. & Econ. Fin. Reg. Res. Program White Paper 2016-1 (2016), http://bit.ly/2hKCBUr.

scrutiny to prevent the State from, in their view, "diminish[ing] the effectiveness" of their "ability to influence consumer decisions." Pet. Br. 31-32 (quoting *Sorrell v. IMS Health Inc.*, 564 U.S. 552, 565, 577 (2011)) (alteration omitted). Several of Petitioners' amici make essentially the same claims and elaborate upon the behavioral economic bases for Petitioners' assertion. *See, e.g.*, Behavioral Economics Scholars Br. 2; Levitin Br. 9, 11; Retail Litigation Center Br. 14, 24; Ahold U.S.A. Br. 19-21.

Petitioners' claim, however, is merely a *hypothesis* about the relative effect of surcharges and discounts on consumer behavior—and one that, as we detail below, lacks any sound empirical basis. This appears to be the first time the Court has been expressly asked "to consider the insights of behavioral economic theory in reaching its decision." Behavioral Economics Scholars Br. 2. The Court should therefore be particularly careful before relying upon unproven speculations about the real-world application of behavioral economic theories—especially when those speculations are, as here, advanced to assert a constitutional basis for striking down a State law.

A. Behavioral Economic Theories Are Malleable And Should Not Be Relied Upon Without Empirical Support.

Petitioners' hypothesis rests primarily on the behavioral economic theory of "loss aversion," which posits a cognitive bias that causes people to react more strongly to transactions framed as losses than to gains of an equivalent value. *See* Pet. Br. 6 (citing Daniel Kahneman et al., *Anomalies: The Endowment*

Effect, Loss Aversion, and Status Quo Bias, 5 J. Econ. Persp. 193, 199 (1991)). Based on this generalized theory—and the assertion that surcharges and discounts can be viewed as "mathematically equivalent," Pet. Br. 26—Petitioners leap to the conclusion that *labels* do all the work, and that surcharge labels are inherently more effective than discount labels at altering consumers' preferred form of payment. Pet. Br. 7 (asserting that consumers are "much more likely to respond to surcharges (perceived as *losses* for using credit) than to discounts (perceived as *gains* for not using credit)").

But absent sound empirical evidence supporting these suppositions, such behavioral theories should not be uncritically accepted. The reality is that, despite their intuitive appeal, behavioral theories—and loss aversion, in particular—often fail to stand up to scrutiny when evaluated and tested against available evidence. *See, e.g.*, Gregory Klass & Kathryn Zeiler, *Against Endowment Theory: Experimental Economics and Legal Scholarship*, 61 UCLA L. Rev. 2, 5 (2013) ("In recent years, experimentalists have published data suggesting that the results of earlier laboratory experiments were not caused by loss aversion.... The legal literature has not kept up.").

The theory of loss aversion is so malleable it can be invoked to explain even opposite outcomes. Notably, in the credit-card surcharge context, a study conducted by the British government invoked the same theories as Petitioners and their amici here to explain a contradictory conclusion. According to the U.K. Office of Fair Trading, the posited "endowment effect

and loss aversion" biases make consumers more vulnerable to surcharges imposed late in the purchase process because "[a]s consumers go through the transaction process, their feelings of ownership increase and therefore so too does their willingness to pay." U.K. Office of Fair Trading, Payment Surcharges: Response to the Which? Super-Complaint 32 (July 2012), http://bit.ly/2fTZYca; *see also* U.K. Office of Fair Trading, The Impact of Price Frames on Consumer Decision Making 9 (May 2010), http://bit.ly/2fLC0RY.

In the realm of consumer credit regulation, numerous behavioral economic theories have been found wanting once the empirical evidence is carefully examined.[4] And studies testing the loss-aversion theory in particular, narrow settings (such as teacher compensation or golfing, *see* Behavioral Economics Scholars Br. 6-7) shed little light on whether or how that

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[4] *See, e.g.*, Thomas A. Durkin, et al., *An Assessment of Behavioral Law and Economics Contentions and What We Know Empirically About Credit Card Use by Consumers*, 22 S. Ct. Econ. Rev. 1 (2014) (debit cards); Tom Brown & Lacey Plache, *Paying with Plastic: Maybe Not So Crazy*, 73 U. Chi. L. Rev. 63 (2006) (credit card borrowing); Robert K. Rasmussen, *Behavioral Economics, the Economic Analysis of Bankruptcy Law and the Pricing of Credit*, 51 Vand. L. Rev. 1679 (1998) (bankruptcy); Ronald Mann, Assessing *the Optimism of Payday Loan Borrowers*, 21 S. Ct. Econ. Rev. 105 (2013) (payday loans); Adam C. Smith & Todd J. Zywicki, *Nudging in an Evolving Marketplace: How Markets Improve Their Own Choice Architecture*, Geo. Mason L. & Econ. Res. Paper No. 16-21 (Apr. 1, 2016), http://bit.ly/2hjY3fa (overdraft protection); Todd J. Zywicki, *The Behavioral Law and Economics of Fixed-Rate Mortgages (and Other Just-So Stories)*, 21 S. Ct. Econ. Rev. 157 (2013) (subprime mortgages).

theory operates in other settings (such as credit-card surcharging by merchants).

B. Petitioners' Surcharge Theories Are Not Supported By Sound Empirical Evidence.

The briefs supporting Petitioners in this case provide only scant evidence for the claim that the practice of surcharging is more effective than discounting in altering consumer behavior—and less support still for the additional claim that the surcharge *label* is responsible for any difference in effects.

In fact, the academic literature on which Petitioners and their amici rely is mostly a *matryoshka* doll of nested citations ultimately leading back to a single 1980 article by Richard Thaler.[5] That article, however, only *speculated* that consumers' cognitive biases might explain why surcharges and discounts have

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[5] *See* Richard Thaler, *Toward a Positive Theory of Consumer Choice*, 1 J. Econ. Behavior & Org. 39 (1980); *see also, e.g.*, Kahneman, *supra*, at 204 (citing Thaler); Amos Tversky & Daniel Kahneman, *Rational Choice and the Framing of Decisions*, 59 J. Bus. S251, S261 (1986), http://bit.ly/2h1cA3x (same); Edmund W. Kitch, *The Framing Hypothesis: Is It Supported by Credit Card Issuer Opposition to a Surcharge on a Cash Price?*, 6 J.L. Econ. & Org. 217, 218 (1990) (same); Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously*, 112 Harv. L. Rev. 1420, 1441 (1999) (citing Tversky & Kahneman, *supra* at S261, which cites Thaler); *see also* Cass R. Sunstein, *What's Available? Social Influences and Behavioral Economics*, 97 Nw. U. L. Rev. 1295, 1312 (2003) (citing nothing).

been treated differently.[6] As the Behavioral Economics Scholars' brief candidly concedes, Thaler's article merely "predicted" that surcharges and discounts might impact consumer behavior differently because the former may be perceived as a loss, and the latter like a reward. Behavioral Economics Scholars Br. 8.

Petitioners' other amici thus plainly mischaracterize the literature when they assert that a "wealth of behavioral economics research" has "demonstrated" Thaler's hypothesis. Retail Litigation Center Br. 13-14; *see also* Ahold U.S.A. Br. 19-21 (suggesting that an "extensive" and "robust body of scientific research" supports Petitioners' First Amendment claim).

Collectively, Petitioners and their amici identify only three sources that purport to provide any empirical support for the claim that credit-card surcharges affect consumer behavior more than cash discounts do, and that this claimed difference is due to consumers' perception that a surcharge is a loss: (1) a survey of Dutch consumers; (2) the internal experience of furniture retailer IKEA; and (3) a new survey that some amici conducted specifically for inclusion in their brief. *See* Levitin Br. 9; Behavioral Economics Scholars Br. 8-11; Ahold U.S.A. Br. 21.[7] When fully and

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[6] *See* Thaler, *supra* note 5, at 45 (positing that card issuers' preference for cash discounts "makes sense *if* consumers" viewed them consistent with the theory of loss aversion) (emphasis added); *see also* Kitch, *supra* note 5, at 218 (referencing Thaler's "casual attempt" to explain the regulatory distinction).

[7] Petitioners themselves do not directly reference any empirical support for the claim, but cite (at Pet Br. 7, 31) articles by

fairly analyzed, however, these sources provide no meaningful support for the claim. And on some critical points, they actually suggest its converse.

Dutch Survey: In a survey of Dutch consumers, a greater percentage of respondents expressed a negative opinion about surcharges (74 percent described them as "bad" or "very bad") than expressed a positive view about discounts (22 percent described them as "good" or "very good"). *See* E. Vis & J. Toth, *The Abolition of the No-Discrimination Rule, Report for European Commission Directorate General Competition* 11-12 (2000), http://bit.ly/2fp0HQ8. These results fail to support Petitioners' claim for at least two reasons.

First, merely asking whether a consumer has a positive or negative opinion about surcharging fails to distinguish answers based on the concept of surcharging or the surcharge label from those based on consumers' experience with specific types of surcharges in practice. As discussed below (at 19-21, 23-24), in jurisdictions that permit surcharging, merchants seem to have engaged in excessive surcharging and insufficient disclosure. Some researchers have found

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amicus Professor Adam Levitin, who in turn cites the same material described herein. *See* Adam J. Levitin, *The Antitrust Super Bowl: America's Payment Systems, No-Surcharge Rules, and the Hidden Costs of Credit*, 3 Berkeley Bus. L.J. 265, 280-81 (2006) (discussing Dutch survey); Adam J. Levitin, *Priceless? The Economic Costs of Credit Card Merchant Restraints*, 55 UCLA L. Rev. 1321, 1351-52 (2008) (same); Adam J. Levitin, *Priceless? The Social Costs of Credit Card Merchant Restraints*, 45 Harv. J. Legis. 1, 19-20 (2008) (same).

that Dutch merchants, in particular, routinely surcharge at rates that substantially exceed the actual cost differential between cash and credit payments. *See* Wilko Bolt et al., *Incentives at the Counter: An Empirical Analysis of Surcharging Card Payments and Payment Behaviour in the Netherlands*, 34 J. Banking & Fin. 1738, 1740 (2010), http://bit.ly/2h2IR8x. Dutch consumers' reported dislike for surcharging thus may simply reflect their dislike for these pricing tactics, not a hypothetical aversion to surcharging per se.[8]

Second, this is merely an opinion survey. Consumer feelings about surcharges and discounts do not establish whether one or the other would be more effective at changing consumer conduct in the real world—much less that the message conveyed by a surcharge *label* would be responsible for that effect. The survey responses described above also say nothing about the percentage of consumers who dislike surcharges but, for whatever reason, will nevertheless accept the fee and pay with credit. *See Impact of Price Frames*, *supra* at 82 (finding that although consumers reported that they "felt cheated and annoyed" by poorly disclosed surcharges, they still typically paid the additional amount).

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[8] Petitioners make a similar mistake in their critique of the State's defense of the law. *See* Pet. Br. 31. That sharp business practices facilitated by surcharging may "cause consumers anger," NY CA2 Br. 9, or "psychologically" annoy consumers "by permitting unannounced price increases at the point of sale," JA 89, does not mean the State is regulating speech, or that it seeks only to diminish the effectiveness of a particular label. *See* Resp. Br. 34.

In fact, although unmentioned by either Petitioners or their amici, the Dutch survey also polled merchants and consumers about their actual experiences with surcharges and discounts. And both groups reported that surcharges were generally *less effective* than discounts at altering consumers' method of payment. *See* Vis & Toth, *supra* at 8-10. Merchants that surcharged estimated that 27 percent of consumers who were informed of the surcharge refrained from using a payment card, while merchants that used discounts reported that 43 percent of those who were offered a cash discount refrained from using a payment card. *See id.* at 8-9. Similarly, consumers in the survey reported that when it came time to make a purchase, they refrained from using a payment card in 38 percent of the transactions in which they were asked to pay a surcharge, but chose to use cash over credit in 50 percent of the transactions in which they were offered a cash discount. *See id.* at 9-10.

These results are directly contrary to the claim put forward by Petitioners and their amici. Although limitations in the survey data caution against relying heavily on the Dutch survey to support claims on either side of this case, it is telling that Petitioners and their amici rely on the survey to support their claim, but conveniently ignore the survey's findings that (whatever its failings) more directly support the relative efficacy of discounts over surcharges in changing consumer behavior.

IKEA Experience: In 2004, IKEA experimented with imposing a surcharge on credit card payments in its United Kingdom stores. IKEA reportedly found that "37 percent of credit card transactions moved to

debit." Scott Schuh et al., *An Economic Analysis of the 2010 Proposed Settlement Between the Department of Justice and Credit Card Networks* 27 (Fed. Reserve Bank of Boston, Public Policy Discussion Paper No. 11-3, 2011), http://bit.ly/2heLxgI. But that finding tends, unsurprisingly, to show only that imposing a cost on the use of a particular form of payment led some consumers to use that payment method less. It says nothing about whether surcharges would cause *more* consumers to switch payment methods than equivalent discounts would—as Petitioners and their amici claim here.[9]

Amici's Survey Conducted for Their Brief: Finally, one group of amici conducted a hypothetical survey "specifically for inclusion" in their brief. Behavioral Economics Scholars Br. 3; *see id.* at 9-11. That they felt the need to conduct a new, ad hoc survey—and did so only *after* the Court had granted the writ of certiorari—highlights just how little support Petitioners and their amici have had for their primary empirical claim during this litigation. The survey's questionable results also illustrate the problems of extrapolating from artificial—and often unrealistic—hypothetical questionnaires to draw inferences about real-world consumer behavior. Although these amici describe the methodology for their "experiment" as the "gold

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[9] Petitioners' amicus who cites the IKEA "study," Levitin Br. 9, notably does not rely on other findings relating to a separate offer IKEA later made to customers in its United States stores regarding a discount on their *next trip* to IKEA. The many differences between these two pricing schemes (not to mention their geographic and temporal differences) preclude any useful comparison between the two. *See* Zywicki et al., *supra* note 3, at 34-35.

standard" for testing psychological hypotheses, *id.* at 9, their evidence is really just a survey of how respondents *think* they might behave in an imagined (and unrealistic) scenario—not an actual experiment that tested how consumers would, in fact, behave if confronted with real incentives. *See* Jae Bong Chang, et al., *How Closely Do Hypothetical Surveys and Laboratory Experiments Predict Field Behavior?*, 91(2) Am. J. Agr. Econ. 518, 532 (2009), http://bit.ly/2h3Y1uc ("[N]onhypothetical choices are a better approximation of 'true' preferences than are hypothetical choices.").

The survey itself was also highly flawed. The survey instructed participants to imagine themselves in a scenario where they sought to purchase $130 in food at a convenience store. When presented with a hypothetical credit-card surcharge, 11 percent of respondents said they would choose to pay with a credit card; when presented with a comparable cash discount, 18 percent said they would do the same. From these results, amici conclude that "describing the price differential in terms of a credit-card surcharge reduced preferences to use a credit card by more than one-third relative to describing the price differential as a cash discount." Behavioral Economics Scholars Br. 10-11.

An obvious red flag is the unrealistically high percentage of participants who claimed they would pay in cash under *either* imagined scenario: 89 percent with the surcharge, and 82 percent with the discount. Those results are strikingly at odds with the available real-world evidence, such as the Danish study described above, where both merchants and consumers

reported that between 27 and 50 percent of consumers refrained from using a payment card when presented with either a discount or a surcharge.

The unrealistically high rates of cash payments in the study likely reflect the unrealistic nature of the imagined scenario itself. The survey instructed participants to "imagine" that they had $220 in cash and were contemplating a $130 purchase. But the hypothetical of carrying $220 in cash does not reflect reality for the vast majority of consumers. According to a recent study, only 8 percent of Americans regularly carry $200 or more in their wallets. *See* Claire Greene & Scott Schuh, *U.S. Consumers' Holdings and Use of $100 Bills* 3, Fed. Reserve Bank of Boston, Research Data Report No. 14-3 (Nov. 2014), http://bit.ly/2hyBAOJ. The median American consumer carries only $22 in cash—a full *order of magnitude* less than postulated by the experiment. *See id.*

A more realistic scenario would thus be something like:

> Imagine that you have a credit card and $22 [not $220] in cash in your wallet/purse. You wish to buy food at a convenience store.
>
> The salesperson says it costs $130 if you pay with cash. If you pay by credit card, there will be a surcharge of around 3%, bringing the total cost to $133.90.
>
> Would you pay by credit card or step out of line to find an ATM so that you can pay by cash instead?

In this more realistic scenario, one would expect far fewer than 80 percent of respondents to claim they would pay in cash when confronted with a surcharge. And that large discrepancy means one can only guess what percentage would pay by a particular method if offered a cash discount instead.[10]

Thus, when the three sources cited by Petitioners and their amici are actually examined, it is clear that they do not support the empirical claim that underlies Petitioners' case—i.e., that the no-surcharge law prevents merchants from using a label that is more effective than a discount label in altering consumer behavior. This Court should not reply upon a theory that is both inherently malleable and unsupported by sound empirical evidence.

II. Surcharges And Discounts Facilitate Different Pricing Practices, With Different Effects On Consumer Welfare.

Petitioners claim that New York's law is a "restriction on speech, not a regulation of conduct," because there is "no real-world difference" between surcharges and discounts aside from their label. Pet. Br. 28 (quoting *Dana's R.R. Supply v. Attorney Gen.*, 807 F.3d 1235, 1245 (11th Cir. 2015)). In other words, Petitioners argue that because surcharges and discounts are "equal in every way except [their] label," only the labels can explain why a State would want to

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[10] This scenario also shows why consumers might dislike the credit-card surcharge but decide to pay it anyway, rather than abandon the transaction and start over at a different store. *See supra* at 9-10.

bar one but not the other. Pet. Br. 6. Several of their amici make a similar claim. *See, e.g.*, Behavioral Economics Scholars Br. 2; Levitin Br. 3, 9; Retail Litigation Center Br. 13, 19; Ahold U.S.A. Br. 19; Frankel Br. 4, 11.

That claim is wrong. Surcharges and discounts facilitate distinct pricing practices. A merchant that imposes a credit-card surcharge advertises one price (the cash price) and *increases* the final price for customers who pay with a credit card. A merchant that offers a cash discount, by contrast, advertises a *different* regular price (a higher, credit-card price) and *decreases* the final price for customers who pay with cash. *See* Resp. Br. 27-28.

Further, because surcharging facilitates a form of revenue extraction that discounting does not, the differential between the credit-card and cash prices is often greater for merchants that impose surcharges than for merchants that offer discounts. In particular, while merchants that offer discounts usually discount based on their costs of accepting credit cards, merchants that impose surcharges often increase the regular price at a rate that is based on the *consumer's* costs in switching to an alternative form of payment.

And retailers are not free to choose any posted price from which to surcharge up or discount down. Because market competition affects a merchant's ability to post a particular price, the posted price from which a merchant discounts will often not be the same as the final price that a merchant would charge after imposing a surcharge.

Because of these fundamental differences, surcharges facilitate at least two pricing practices that discounts do not.

First, surcharges allow merchants to post a lower regular price (on the shelf, in the storefront, or in an advertisement) than the credit-card price. Advertising a price that is lower than the maximum price a consumer may eventually pay makes it difficult for consumers who typically pay with a credit card to compare prices and make purchasing decisions.

Second, surcharges, but not discounts, allow merchants to earn above-cost profits when customers are unable efficiently to provide an alternative form of payment. Having invested time in the shopping process, decided to purchase her items, and waited to check out, the customer may accept a higher price to complete her purchase with a card (assuming she does not have sufficient cash) in order to avoid the cost of duplicating this effort. Although the credit-card interchange fee may be only 2 or 3 percent, for example, a merchant can use a surcharge to impose an additional premium on top of the posted price. The customer blames the credit-card company (because calling the price increase a "credit-card surcharge" suggests the merchant is merely passing on the credit-card fee), while the merchant pockets the difference.

As we detail below, the real-world experience from jurisdictions where surcharges are allowed confirms that surcharges tend to engender these pricing practices. And unlike credit-card surcharges, cash discounts do not facilitate these practices. Merchants

have incentives to broadly publicize any discount offers, and no merchant would discount a penny more than its actual cost of accepting credit to encourage a cash transaction—otherwise the merchant would be taking money out of its own pocket.

Thus, contrary to the arguments of Petitioners and their amici, surcharges and discounts are economically different pricing practices that can have materially different effects on consumer welfare.

A. Surcharges, But Not Discounts, Facilitate Inadequate Price Disclosures.

Both surcharges and discounts allow merchants to charge different prices to customers based on the customers' preferred method of payment. But unlike discounts, surcharges allow merchants to advertise a price that is *lower* than the final price that some customers will eventually pay. *See* Helene Bourguignon et al., *Card Surcharges and Cash Discounts: Simple Economics and Regulatory Lessons*, 10 Competition Pol'y Int'l 13, 20 (Autumn 2014); Resp. Br. 49-50. Advertising a price lower than the final price "reduce[s] the extent to which consumers [can] shop around and compare full price offers" and therefore "weakens the competitive pressure between retailers" and often results in "consumers not getting the best deal." *Payment Surcharges*, *supra* at 7.

To illustrate, suppose a consumer wants to buy a mattress. Store A advertises a price of $1,000, while Store B advertises a price of $1,030. Since the consumer buys a mattress only once every ten years, she does not readily know that only Store B's advertised

price reflects a baseline increase to cover credit-card acceptance costs. Accordingly, the consumer decides to shop at Store A. After spending an hour lying down on every mattress in the store, the consumer finally chooses the one she wants to buy. But when she reaches the checkout, the consumer learns that the advertised price of $1,000 does not include a 6 percent surcharge, which brings the grand total to $1,060. Because the consumer is carrying only $22 in cash (as the median American does, *see supra* at 14), and because the $30 difference between the two stores' credit-card prices may well be less than the value of the time it would take to find a comparable mattress at Store B, the customer may effectively be locked into paying the higher price.

In jurisdictions that permit credit-card surcharging, some merchants will inevitably employ this form of advertising. And when they do, merchants that would rather disclose any surcharge as part of their advertised price (like Store B above) are placed at a competitive disadvantage because they must advertise higher prices than their competitors'. *See Payment Surcharges*, *supra* at 28 n.25. Competitive pressure can thus encourage merchants to impose surcharges and limit their disclosure of those charges. Contrary to Petitioners' assertion that New York's law limits "the dissemination of truthful, non-misleading price information," Pet Br. 30, the law actually prohibits a practice that can impede the efficient dissemination of price information.

Jurisdictions that permit only cash discounting, by contrast, do not have this problem. There, an advertised price is the maximum price that a customer

will have to pay, and a merchant has strong incentives to publicize available discounts as a way to entice customers to shop at the store. *See* Resp. Br. 50-51. And in contexts where most purchases are via credit card (such as online, or for big-ticket items like hotels and airline tickets), the advertised price will be the real price for the vast majority of consumers. Further, to the extent that the advertised price differs from the price for paying in cash, the difference in price redounds to the customer's benefit.

Real-world experience shows that that credit-card surcharges are often employed to attract customers with seemingly competitive posted prices, only later to saddle them—sometimes at the very end of the transaction process—with an additional charge. *See* Ian Lee et al., *Credit Where Its Due: How Payment Cards Benefit Canadian Merchants and Consumers, and How Regulation Can Harm Them* 20-22 Macdonald-Laurier Institute (Oct. 2013), http://bit.ly/2hHsHje; Resp. Br. 49-50. As Nobel Laureate economist Jean Tirole and his colleagues have observed, a nearly ubiquitous feature of "international experiences with surcharging" is that "card surcharges are only announced at the point of sale, after consumers [have] incurred significant shopping costs." Bourguignon, *supra* at 19.

The British government has documented this phenomenon in online shopping, where surcharges are often disclosed only at the final screen of the checkout process. *See Payment Surcharges*, *supra* at 35-36 (observing that businesses often do not inform customers of a surcharge until the customer has "gone

through four to six web pages, where numerous decisions have to be made to tailor the product and where personal information often has to be provided"). Similarly, at least two studies of foreign jurisdictions have found that consumers often learn of surcharges only *after* a transaction has gone through or—even worse—*do not recall being notified of the surcharge at all*. *See* Vis & Toth, *supra* at 8 (approximately 11 percent of merchants in the Netherlands reported that they did not inform their customers of the surcharge); *accord* CHOICE, Credit Card Surcharging in Australia 14 (2013), http://bit.ly/1ACjSYt.

Real-world experience also reveals that merchants impose surcharges most often when customers tend to be "one-time or infrequent" shoppers lacking the opportunity to learn about a business's pricing practices. *See* Bourguignon, *supra* at 22. Examples include businesses such as air and holiday travel companies, restaurants, taxis, and gas stations. *See id.*; *see also* European Commission, Study on the Impact of Directive 2007/64/EC on Payment Services in the Internal Market and on the Application of Regulation (EC) No 924/2009 on Cross-Border Payments in the Community at 74, tbl.20 (Feb. 2013), http://bit.ly/2gpOevU (finding that a significantly greater percentage of merchants in the travel, hotel, and hospitality sector imposed surcharges than did merchants generally). The British government similarly has found that surcharging occurs most frequently where "consumers incur search costs to discover the surcharge." *Payment Surcharges*, *supra* at 29-30. The use of surcharges in these contexts is not to encourage the use of cash, but rather is to extract a premium charge on a vulnerable customer.

B. Surcharges, But Not Discounts, Facilitate Supracompensatory Prices.

Surcharges also create opportunities for merchants to charge supracompensatory prices by increasing surcharge rates beyond their costs of accepting credit cards. Many customers will simply pay the additional amount because they have no viable alternative to paying with a credit card by the time they learn of the surcharge. And the customer will often incorrectly believe that the additional fees are the fault of the credit-card company, and not the merchant—i.e., that the merchant is just "passing it on."

To return to the mattress-store example above (at 18-19), the consumer will decide to shop at Store A because its advertised price ($1,000) is lower than Store B's ($1,030), and the consumer does not have information about either store's surcharging practices. Once there, the consumer (carrying less than $1,000 in cash) often minimizes her own costs by simply paying the surcharge, rather than terminating the transaction and beginning anew at another mattress store. Knowing this, the store can maximize its profits by setting the surcharge rate *just below* the consumer's threshold for continuing with the transaction. That rate may be far in excess of the store's cost of accepting credit cards, and, in any event, will bear no necessary relationship to that cost—the recovery of which is ostensibly the reason for imposing the surcharge.

Cash discounting, by contrast, does not facilitate such pricing practices because market competition operates more effectively to ensure that cash discount rates reflect a merchant's actual costs of card acceptance. Consequently, a merchant generally will not be able to use cash discounts to extract above-cost profits because doing so would require the merchant to *advertise* the supracompensatory price. And in a competitive market, advertising a higher price will disadvantage the merchant, as competitors with similar marginal costs can advertise lower prices.[11] *See* Resp. Br. 31-33, 48-49. Further, a merchant has no economic incentive to offer a cash discount that exceeds the amount of its cost of accepting credit cards. To do so would generally erode the merchant's profit margin. Thus, while cash discounts will, as a practical matter, rarely exceed the actual cost difference between two payment devices, surcharges lack this inherent limitation.

Here again, the real-world experience in other countries confirms that surcharges facilitate above-cost pricing. As noted above (at 9-10), researchers have found that Dutch merchants routinely surcharged at rates that substantially exceeded the actual cost differential between cash and credit payments. *See* Bolt et al., *supra* at 1740. Another investigation in 2016 found that many British merchants imposed surcharges between 1 and 3 percent, even though the marginal cost to British merchants of credit card transactions was between 0.3 and 0.6

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[11] Petitioners entirely ignore this real-world limitation when they contend that New York's law allows profiteering via discounts. *See* Pet. Br. 41.

percent. *See* James Daley, *Why Are We Still Being Charged for Paying By Credit Card?*, FairerFinance.com (Aug. 11, 2016), http://bit.ly/2gE4j41; *see also Payment Surcharges*, *supra* at 38.

Australia has had the same experience, and one study found that Australian businesses "embraced surcharges as a new revenue stream." CHOICE, *supra* at 8; *see id.* at 12-13. The central bank's own analysis also found that "surcharge levels on some transactions appear to be well in excess of merchants' likely acceptance costs." Reserve Bank of Australia, Review of Card Payments Regulation 30 (May 2016), http://bit.ly/2g4Icnz. As a result, the central bank and the Australian government have had to adopt further reforms in an attempt to regulate what it deems "excessive surcharging." *Id.*

CONCLUSION

Petitioners' behavioral hypothesis that consumers will react more strongly to surcharges than to discounts of equivalent value is purely speculative and lacks empirical confirmation. In the absence of sound empirical evidence, this Court should not rely upon malleable behavioral economic theories in crafting constitutional law.

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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APPENDIX*

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